

Message Text

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ACTION NEA-16

INFO OCT-01 ISO-00 AID-20 CIAE-00 COME-00 EB-11 FRB-03

INR-11 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 SP-03

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CEA-02 AGR-20 PA-04 PRS-01 USIA-15 FEA-02 FPC-01

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R 141755Z AUG 74

FM AMEMBASSY NEW DELHI

TO SECSTATE WASHDC 3288

INFO AMCONSUL BOMBAY

AMCONSUL CALCUTTA

AMCONSUL MADRAS

AMEMBASSY ISLAMABAD

AMEMBASSY DACCA

AMEMBASSY KATHMANDU

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E.O. 11652: N/A

TAGS: ECON, IN

SUBJ: INDIA'S CURRENT DOMESTIC SCENE: LOTS OF JAWBONING, LOTS
OF STAGNATION, LOTS OF INFLATION, SOME HOPEFUL PORTENTS

1. SUMMARY: ALL AGREE THAT THE INDIAN ECONOMY IS IN TROUBLE.
AGRICULTURAL OUTPUT WILL BE LUCKY TO EQUAL LAST YEAR'S WHILE IND-
USTRIAL OUTPUT IS CLEARLY DOWN. INFLATION IS RAGING. THINGS HAVE
REACHED THE POINT WHERE ECONOMICS HAS BECOME IMPORTANT ENOUGH TO
BECOME POLITICS, AND MRS. GANDHI IS BARNSTORMING THE COUNTRY ON
ECONOMIC ISSUES.

MEASURES TAKEN SO FAR DO NOT HOLD OUT MUCH PROMISE. THE HOPE
HAS TO BE THAT SOMETHING WILL BE DONE TO GET PRODUCTION MOVING
AND THAT THE KEY STEP OF TAXING AGRICULTURAL INCOME WILL SOMEHOW
BE TAKEN. END SUMMARY

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2. GIVEN THE SHORTCOMINGS AND DELAYS OF INDIAN STATISTICS ANY ATTEMPT TO ASSESS THE CURRENT STATE OF THE INDIAN ECONOMY MUST BE LARGELY IMPRESSIONISTIC. HOWEVER, EVERYBODY'S IMPRESSIONS -- INCLUDING THE GOI'S -- POINT THE SAME GLOOMY WAY. THE ECONOMY IS STAGNANT AND IS PROBABLY IN SEVERE RECESSION. HOW DEEP THE RECESSION WILL EVENTUALLY BE IS GOING TO DEPEND IN PART ON WHAT HAPPENS TO THE MONSOON NOW GOING ON, SINCE BOTH AGRICULTURE AND ELECTRIC POWER DEPEND ON IT. BY NOW IT SEEMS CLEAR THAT DESPITE A RECENT IMPROVEMENT, THIS SUMMER'S MONSOON WILL NOT BE A VERY GOOD ONE. CERTAINLY IT WILL NOT MATCH LAST YEAR'S. THE BEST THAT CAN BE HOPED FOR IS THAT AGRICULTURAL PRODUCTION FROM THE CURRENT CROP WILL ABOUT MAINTAIN LAST YEAR'S LEVEL, WHICH WAS BETTER THAN THE YEAR BEFORE BUT WORSE THAN 1970/71. THERE ARE 45 MILLION MORE PEOPLE THAN THERE WERE THEN. EVEN SO IT MAY VERY WELL NOT DO SO, AND WE WON'T KNOW FOR SURE FOR SEVERAL MONTHS. WE DO KNOW THAT TRANQUILITY IN THE CITIES WILL HAVE TO BE BOUGHT AT THE PRICE OF SUBSTANTIAL IMPORT OF FOODGRAINS. THE SERIOUSNESS OF THE MALAISE IS NOW ATTRACTING THE ATTENTION OF INDIA'S TOP POLITICAL LEADERSHIP IN A WAY WE HAVE NOT SEEN BEFORE (SEE PARA 10).

3. INDUSTRIAL PRODUCTION WHICH WAS ABSOLUTELY FLAT IN 1973, IS EVEN DECLINING THIS YEAR. ACCORDING TO THE COMMERCE RESEARCH BUREAU, OUTPUT IN SELECTED INDUSTRIES AMOUNTING TO A LITTLE OVER HALF OF THE WEIGHTING IN THE INDUSTRIAL PRODUCTION INDEX WAS DOWN BY MORE THAN 4 PERCENT IN THE FIRST FOUR MONTHS OF 1974. THE SHORTAGE OF ELECTRIC POWER IN BENGAL HAS HIT THE JUTE INDUSTRY HARD, WITH PRODUCTION OFF BY 30 PERCENT FROM LAST YEAR. THE COMMERCE MINISTRY WOULD LIKE TO IMPORT CAPTIVE ELECTRIC GENERATING PLANTS, BUT IS STYMIED BY THE FINANCE MINISTRY AND ALSO BY THE MINISTRY OF INDUSTRIAL DEVELOPMENT WHICH WANTS TO USE THE OCCASION TO DEVELOP DOMESTIC CAPABILITY IN THIS AREA. A LOT OF INDIA'S PROBLEMS STEM FROM BUREAUCRATIC STALEMATES OF THIS SORT. SHORTAGES OF ELECTRIC POWER AND COAL ARE ALSO SEVERELY AFFECTING THE STEEL AND ALUMINUM INDUSTRIES. PIG IRON PRODUCTION IS OFF BY 12 PERCENT FROM LAST YEAR AND ALUMINUM OUTPUT IS OFF BY 28 PERCENT. INFLATION IS DEPRESSING CONSUMER DURABLES INDUSTRIES AS LARGER PROPORTIONS OF CONSUMER INCOME ARE NECESSARILY UTILIZED FOR FOOD AND OTHER BASIC NECESSITIES.

4. BOTTLENECKS ARE STILL TAKING THEIR TOLL. THE MOST SERIOUS IS LIMITED OFFICIAL USE

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ELECTRIC POWER. THE PERFORMANCE OF THE MONSOON WILL BE IMPORTANT HERE. SOME PREVIOUSLY DEPLETED RESERVOIRS ARE FILLING; OTHERS ARE STILL LOW AND THE FUTURE PERFORMANCE OF THEIR PENSTOCKS DEPENDS ON RAIN THAT MAY NOT COME. THERMAL STATIONS MUST TAKE UP THE SLACK, BUT BAD MAINTENANCE AND SHORTAGES OF COAL LIMIT THEIR ABILITY TO DO SO. THE RAILROADS ARE OPERATING BELOW MAY 1974 PRE-STRIKE LEVELS AND COAL IS PILING UP AT THE PITHEADS.

5. ON THE BRIGHTER SIDE, THERE IS GOOD EXPORT DEMAND HELPING THE HEAVY ENGINEERING INDUSTRY AND THERE IS ALSO INCREASED OUTPUT IN SUCH INDUSTRIES AS SUGAR, RUBBER PRODUCTS AND A FEW OTHERS, BUT THESE STRONG SPOTS ARE INSUFFICIENT TO BALANCE THE DECLINES ELSEWHERE.

6. ALTHOUGH IMPORT PRICES ARE UP SHARPLY, ESPECIALLY FOR PETROLEUM, FERTILIZER, AND FOOD, ECONOMIC STAGNATION AND A RESTRICTIVE IMPORT POLICY CONTINUE TO LIMIT IMPORTS. WORLD INFLATION CONTINUES TO ASSIST INDIAN EXPORT PRICES AND EXPORT EARNINGS ARE RISING BY MORE THAN 20 PERCENT ANNUALLY. THE COMBINATION OF LIMITED IMPORTS AND GOOD EXPORT EARNING, PLUS THE DRAWING OF INDIA'S FIRST CREDIT TRANCHE WITH THE IMF, HAVE LEFT INDIA WITH RECORD FOREIGN RESERVES.

7. THE DOMESTIC STAGNATION IS ACCOMPANIED BY STILL RAGING INFLATION. THE WHOLESALE PRICE INDEX AT THE END OF JULY WAS 26 PERCENT HIGHER THAN A YEAR EARLIER, WHILE THE RETAIL PRICE INDEX AT THE END OF JUNE WAS 24 PERCENT HIGHER THAN A YEAR EARLIER. THIS DISTRESSING SITUATION HAS LED TO A FLURRY OF ACTIONS AND OF TALK, WHICH WE HAVE BEEN REPORTING IN A NUMBER OF MESSAGES OVER THE PAST SEVERAL WEEKS, CULMINATING WITH NEW DELHI 10221. THE SERIES OF QUITE MILD AND ORTHODOX MEASURES THE GOVERNMENT BEGAN TAKING LAST MONTH -- COMPULSORY DEPOSITS, TAX INCREASES, INTEREST RATE INCREASES, AND DIVIDEND LIMITATIONS -- WILL HAVE LIMITED EFFECT BY THEMSELVES. THE GOVERNMENT IS AWARE THAT WHAT HAS BEEN DONE TO DATE IS NOT ENOUGH, AND GOVERNMENT ECONOMICISTS KNOW THAT THE STRENGTH OF THE MONSOON IS MORE IMPORTANT THAN ALL THE MEASURES SO FAR ANNOUNCED. SOME HARSHER PROPOSALS, INCLUDING SOME PROPOSALS FOR TAXES ON AGRICULTURE, WERE KILLED OFF ALONG THE WAY. HOWEVER, THEY CAN BE RESURRECTED. THE EMPHASIS ON FIGHTING INFLATION HAS LED TO AN IMBALANCE, IN THAT THE MEASURES SO LIMITED OFFICIAL USE

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FAR ARE DIRECTED SOLELY AT THE DEMAND SIDE, EVEN THOUGH IT IS CERTAINLY IMPORTANT TO DO SOMETHING ON THE SUPPLY SIDE IF INFLATION IS TO BE BROUGHT UNDER CONTROL AND THE RECESSION ENDED. IN FACT, SOME OF THE MEASURES, PARTICULARLY THE DIVIDEND LIMITATION AND THE INTEREST RATE INCREASES, WILL FURTHER INHIBIT ECONOMIC ACTIVITY.

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DRC-01 /177 W

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8. EXCEPT FOR AN APPARENTLY GENUINE STEP UP IN INCOME TAX ENFORCEMENT, THE MEASURES ALSO AVOID COMING TO GRIPS WITH THE PROBLEMS OF BLACK MONEY, AND THE DISTORTIONS IN PRODUCTION AND INCOME DISTRIBUTION BLACK MONEY CAUSES. (SOME SAY THIS IS BECAUSE THE CONGRESS PARTY DERIVES MUCH REVENUE FROM CONTRIBUTIONS OUT OF BLACK MONEY. TRUE. BUT IN FAIRNESS, THIS IS AN EXTREMELY DIFFICULT TECHNICAL PROBLEM TO GET AT. IT IS A PERVASIVE OUTGROWTH OF THE COMPLEX SYSTEM OF DIRECT CONTROLS WHICH HAVE BECOME CENTRAL TO THE MANAGEMENT OF THE INDIAN ECONOMY AND BLACK MONEY IS BY THIS POINT INEXTRICABLY LINKED WITH THEM).

9. MOST IMPORTANTLY, THE MEASURES SO FAR TAKEN DO NOT GET AT THE SUBSTANTIAL UNTAXED PROFITS IN AGRICULTURE. AN EQUITABLE SYSTEM OF TAXATION OF AGRICULTURAL INCOME WOULD GO A LONG WAY TOWARD SOAKING UP EXCESS DEMAND CAUSED BY BUDGET DEFICITS AND ALSO TOWARD

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MOBILIZING RESOURCES FOR ECONOMIC DEVELOPMENT. IT WOULD ALSO HELP TO STOP THE ALARMING DETERIORATION IN INCOME DISTRIBUTION THAT IS CAUSING AN INCREASING SHARE OF THE POPULATION TO DROP BELOW THE

OFFICIAL POVERTY LINE. THEREFORE, IT IS ENCOURAGING THAT MRS. GANDHI AND ESPECIALLY FINANCE MINISTER CHAVAN HAVE BEEN PUTTING THE SQUEEZE ON THE STATES TO GET THEM TO FIND WAYS TO RAISE MORE REVENUE AND REDUCE THEIR DEPENDENCE ON THE CENTRAL GOVERNMENT. THEY HAVE THREATENED TO STOP HONORING THEIR RUBBER CHECKS. OF COURSE, FOR THE STATES TO RAISE MORE OF THEIR OWN MONEY MUST MEAN TAXING AGRICULTURE. THIS IS OPPOSED BY THE WEALTHY FARMERS AND THE WEALTHY FARMERS FORM THE BASIS OF THE CONGRESS PARTY SUPPORT STRUCTURE IN MOST OF INDIA. THERE ARE, HOWEVER, INCREASING INDICATIONS THAT MRS. GANDHI IS AWARE OF THE PROBLEM AND OF THE NECESSITY FOR RAISING REVENUE FROM THE WEALTHY FARMERS AND MAY BE WILLING TO RISK THEIR IRE, JUST AS SHE RISKED THE IRE OF ORGANIZED LABOR IN THE RAIL STRIKE LAST SPRING. WHILE SHE WAS ABLE TO STRIKE DIRECTLY AT THE WORKERS, HOWEVER, AGRICULTURE IS A "STATE SUBJECT" AND SHE MUST WORK INDIRECTLY THROUGH THE POLITICAL LEADERS IN EACH STATE. THIS TO SOME EXTENT INSULATES MRS. GANDHI PERSONALLY FROM THE POLITICAL IMPACT OF PRESSURES ON THE WELL-TO-DO FARMERS. BUT IT ALSO MAKES IT MUCH MORE DIFFICULT FOR HER TO ENFORCE AND IMPLEMENT ANY REAL RURAL TAX REFORM.

10. THERE IS GROWING SENTIMENT IN INDIA THAT THINGS HAVE GOTTEN SO BAD THAT SOMETHING MORE THAN THE MEASURES TO DATE, TRADITIONAL CONGRESS RHETORIC AND EXHORTATIONS ARE GOING TO BE NECESSARY IF INDIA IS EVEN GOING TO GET OUT OF THE MIRE. INDIA'S ECONOMIC PROBLEMS HAVE BECOME SUFFICIENTLY IMPORTANT TO BECOME SERIOUS POLITICS. IN RECENT WEEKS MRS. GANDHI HAS PLUNGED INTO AN AMBITIOUS, PERSONAL CAMPAIGN TO OVERCOME THE SENSE OF PESSIMISM. IN MAHARASHTRA, SHE RECENTLY PUBLICLY REBUKED THE CHIEF MINISTER FOR MAHARASHTRA'S FAILURE TO RAISE MORE FOOD. SHE EXTRACTED A PLEDGE FROM HIM TO MAKE MAHARASHTRA SELF-SUFFICIENT IN FOOD IN THREE YEARS. (SUCH PLEDGES ARE EASIER TO MAKE THAN TO FULFILL. THE SAME MINISTER SAID IN 1965 THAT HE SHOULD BE HANGED IF HE COULDN'T ACHIEVE FOOD SELF-SUFFICIENCY IN THREE YEARS). OFFICIALS IN GUJARAT MADE THE SAME PLEDGE. ACTING MINISTER OF FOOD AND AGRICULTURE SUBRAMANIAM UPPED THE ANTE THIS WEEK WITH A PLEDGE THAT INDIA WOULD BE SELF-SUFFICIENT IN FOOD IN 18 MONTHS. THIS DOES NOT INSPIRE US WITH HOPE. IT WOULD BE ENCOURAGING IF EVERYONE BEGAN WORKING HARDER, PUTTING BUREAUCRATIC SQUABBLES TO LIMITED OFFICIAL USE

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ONE SIDE, AND SUBDUED THEIR RHETORIC. INSTEAD, DESPITE WHAT MAY BE MRS. GANDHI'S OWN INCREASING SENSE OF ALARM AND FOCUS ON THE DISMAL ECONOMIC PROSPECTS, POLITICS SEEM TO GO ON AS USUAL. BUT MRS. GANDHI MAY INDEED BE DEADLY SERIOUS AND THOSE POLITICIANS WHO DON'T REALIZE THIS MAY FIND THEMSELVES OFF IN THE WEEKS IN THE NEXT FEW MONTHS. WE HOPE TO BE ABLE TO REPORT SOME POSITIVE DEVELOPMENTS IN THE MONTHS AHEAD.
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